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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 720

ISADORE BLAU, a stockholder of AIR-WAY INDUSTRIES, INC., suing on behalf of himself and all other stockholders similarly situated and on behalf and in the right of Air-Way Industries, Inc.,

Petitioner,

vs.

EDWARD LAMB and EDWARD LAMB ENTERPRISES, INC.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

ALBERT R. CONNELLY
ROBERT ROSENMAN
Counsel for Respondents
One Chase Manhattan Plaza
New York, New York 10005

CRAVATH, SWAINE & MOORE
Of Counsel.

November 7, 1966.

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BRIEF FOR RESPONDENTS IN OPPOSITION

COUNTERSTATEMENT OF QUESTIONS PRESENTED

The questions presented by the Petition, although stated by the Petitioner in the form of five questions, are in substance only two:

(1) Is there any liability under Section 16(b) of the Securities Exchange Act of 1934 for a "profit realized" by an insider by reason of the acquisition of a convertible security and the conversion thereof within six months where the convertible security and the security into which it is converted are economic equivalents in terms of their opportunity for appreciation in market value?

(2) Does the acquisition of securities of an issuer by an insider corporation constitute a "purchase" of the securities within the meaning of Section 16(b) of the Securities Exchange Act of 1934 where the owners of 100% of the acquiring insider corporation own 97% of the transferring corporation?

SUMMARY OF BASES FOR DENIAL OF PETITION

(1) With respect to the first question, no decision of a United States Court of Appeals conflicts with the decision in this case. In a similar fact situation, the Court of Appeals for the Third Circuit relied upon a different rationale in coming to the identical conclusion that no liability exists. Moreover, the decision below is of limited importance because the Securities and Exchange Commission has now adopted a rule exempting from Section 16(b) all similar transactions after the effective date of the rule.

(2) With respect to the second question, no decison of a Court of Appeals conflicts with the decision in this case, and Petitioner does not assert that a conflict exists. The decision is limited to the facts of this case and does not have any broad significance.

(3) The decision below as to both transactions was correct.

THE FACTS

Petitioner seeks review of the decision of the Court of Appeals for the Second Circuit (a copy of which is attached to the Petition) to the extent that it held that two transactions (referred to herein as the "Conversion Transaction" and the "Transfer Between Corporate Pockets

Transaction") did not result in any liability under Section 16(b) of the Securities Exchange Act of 1934.[1]

(1) The Conversion Transaction.

In June 1955 the decision was made to combine Air-Way Industries, Inc. ("Air-Way") with Lamb Industries, Inc. ("Lamb Industries"). At the time, Edward Lamb ("Lamb"), members of his family, and corporations controlled by them owned at least 35½% of the outstanding shares of Common Stock of Air-Way and had five of their nominees among the seven directors of Air-Way (R. A7, 9).[2] Lamb, members of his family, and corporations controlled by them owned 97% of Lamb Industries (R. A7).

On June 9, 1955, the Board of Directors of Air-Way approved an offer to the shareholders of Lamb Industries to exchange one share of 5% Cumulative Convertible Preferred Stock of Air-Way for each five shares of Common Stock of Lamb Industries (R. A10). The Air-Way Preferred was convertible at any time into Air-Way Common at a rate of 3½ shares of Air-Way Common for each share of Air-Way Preferred. In the event of any stock dividend or split-up by reclassification or other method of the shares of Air-Way Common, the number of shares of Air-Way Common into which the shares of Air-Way Preferred were convertible would be appropriately adjusted (R. A49-52).

In accordance with Air-Way's offer, Lamb and Edward Lamb Enterprises, Inc. ("Lamb Enterprises"), a corpora-

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[1]The decision below reversed the judgment of the District Court on all questions not conceded by Respondents. Petitioner does not seek review with respect to transactions other than the two herein described.

[2]References are to pages of the Record certified to this Court by the Clerk of the United States Court of Appeals for the Second Circuit.

tion 100% owned by Lamb, members of his family, and corporations controlled by them, exchanged an aggregate of 199,245 shares of Lamb Industries Common for an aggregate of 39,849 shares of Air-Way Preferred during the period of July through September 1955 (R. A11-12). On September 13, 14, and 15, 1955, Lamb and Lamb Enterprises converted those 39,849 shares of Air-Way Preferred into Air-Way Common (R. A12).

Petitioner asserted, and Respondents conceded, that the acquisition of the Air-Way Preferred constituted a "purchase" within the meaning of Section 16(b). Petitioner asserted that the conversion of the Air-Way Preferred constituted a "sale" within the meaning of Section 16(b) and that a "profit" had been "realized" by Respondents from those transactions equivalent to the difference in the value of the Lamb Industries Common given in exchange for the Air-Way Preferred and the value of the Air-Way Common issued upon conversion of the Air-Way Preferred. The District Court adopted Petitioner's theory and held Respondents liable for a "profit realized" of $1,138,782.31 (R. A41-42).

On appeal, Respondents contended that the conversion did not give rise to any liability, on the alternative grounds either that there was no "sale" or that there was no "profit realized". Because the Air-Way Preferred and Air-Way Common were economic equivalents and Respondents' investment was subject to at least as great a market risk following conversion as prior to conversion,[3] there

[3]In the context of Section 16(b), securities are "economic equivalents" when their market values fluctuate on an equivalent basis. The market value of a convertible security, such as the Air-Way Preferred, will fluctuate in direct relationship with the market value of the security into which it is convertible, except that the market value of the convertible security will not fall below the value of that security without the conversion feature. Thus the opportunities for appreciation are the same regardless of which security is held; the risk of loss is somewhat greater after conversion.

was no opportunity to profit from use of inside information and hence no basis for construing the definition of "sale" in Section 16(b) to cover the conversion transaction; and, in any event, since Respondents' investment position was identical (except for a somewhat greater downside risk) before and after conversion, no "profit" was "realized". The Securities and Exchange Commission in its *amicus* brief in the court below supported Respondents' alternative position that there was no "profit realized".

The Court of Appeals reversed the decision of the District Court on the ground that the conversion of the Air-Way Preferred did not constitute a "sale" within the meaning of Section 16(b):

> "[W]e hold that the economic equivalence of the Air-Way Preferred and the Air-Way Common and the unchanged investment position of Lamb and Enterprises combined to insure that this conversion afforded the insiders no opportunity to realize a gain by speculative trading in Air-Way Preferred. For this reason, we hold that the conversion was not a Section 16(b) sale of the Preferred." (R. A89)

The Court of Appeals explicitly limited its decision to the type of transactions here involved—a purchase of a convertible security and a conversion of that security (R. A92-93).

(2) The Transfer Between Corporate Pockets Transaction.

On June 6, 1955, Lamb Industries transferred to Lamb Enterprises 68,100 shares of Air-Way Common as part of an exchange of assets (R. A18-19). The transfer was treated by the District Court as a "purchase" by Lamb Enterprises of the 68,100 shares, even though the Lamb interests owned

100% of Lamb Enterprises and 97% of Lamb Industries. The District Court held Respondents liable for profits totaling $156,229.02 based in part on that "purchase" (R. A41-42).

Respondents appealed from that determination on the ground, among others, that the transfer from Lamb Industries to Lamb Enterprises was not a "purchase" by Lamb Enterprises within the meaning of Section 16(b). The Securities and Exchange Commission in its *amicus* brief supported Respondents' position. The Court of Appeals reversed and held that the transaction was not a "purchase" by Lamb Enterprises:

> "By virtue of Lamb's pervasive control over Industries and Enterprises, there was at most a token change in the insider's investment position when Air-Way Common was transferred from Industries to Enterprises; Lamb indirectly owned this stock both before and after its transfer. Thus Lamb did not place himself where he could make any more advantageous use of inside information for speculative purposes than he could have before the transfer. Nor did the decision to transfer the Air-Way Common alter the nature of his investment, increase or decrease the amount invested, or alter in any way the risks involved." (R. A97)
>
> "...
>
> "The transfer to Enterprises of the Air-Way Common in no way increased Lamb's power to make use of inside information, and for this reason that transfer was not a Section 16(b) 'purchase' of the Common." (R. A98).

ARGUMENT

I. NO CONFLICT OF DECISIONS EXISTS.

There is no Court of Appeals decision conflicting with the result reached by the Court of Appeals for the Second Circuit in this case. Petitioner does not even assert a conflict with respect to the Transfer Between Corporate Pockets Transaction. Although Petitioner asserts that the decision in *Heli-Coil Corp.* v. *Webster,* 352 F. 2d 156 (3d Cir. 1965) "conflicts directly with the decision [as to the Conversion Transaction] rendered below . . ." (Petition, page 15), no such conflict exists.

Heli-Coil involved two separate alleged "purchases" and "sales": (i) the acquisition of convertible debentures and the conversion of the debentures into common stock within six months and (ii) the acquisition of common stock upon conversion of the debentures and the sale of the common stock for cash within six months. The first pair of transactions in *Heli-Coil* presented the same question raised by the Conversion Transaction in this case. The Court of Appeals for the Third Circuit held that no liability existed with respect to the acquisition of the debentures and their conversion within six months. A majority of the Court of Appeals for the Third Circuit held that there was no liability on the ground that there was no "profit realized" (352 F. 2d at 167-68), while Judges Hastie and Kalodner reached the same result on the ground that the conversion was not a "sale" (352 F. 2d at 171-74). The second pair of transactions in *Heli-Coil* does not have any counterpart in this case.

II. THE QUESTION OF LIABILITY WITH RESPECT TO THE CONVERSION TRANSACTION IS OF LIMITED IMPORTANCE BECAUSE SUCH TRANSACTIONS HAVE NOW BEEN EXEMPTED FROM SECTION 16(b) BY RULE 16b-9.

The decision of the Court of Appeals with respect to the Conversion Transaction is of limited importance because

the Securities and Exchange Commission has now specifically exempted from the scope of Section 16(b) all such transactions. Under the last sentence of Section 16(b), the Securities and Exchange Commission has the power to exempt transactions "not comprehended within the purpose of" Section 16(b). Pursuant to that authority, the Commission adopted Rule 16b-9, 31 Fed. Reg. 3391 (1966), amending 17 C. F. R. 240. 16b-9 (1964), a copy of which is annexed as an Appendix. That Rule, effective February 17, 1966, exempts (with certain exceptions not relevant to the Conversion Transaction) any acquisition or disposition of an equity security upon the conversion of an equity security into another equity security of the same issuer.

This Court has frequently refused to grant a writ of certiorari where because of a change in the applicable law the question involved was no longer significant. *United States* v. *Abrams,* 197 F. 2d 803 (6th Cir. 1952), *cert. denied,* 344 U. S. 855; *United States* v. *Community Servs., Inc.,* 189 F. 2d 421 (4th Cir. 1951), *cert. denied,* 342 U. S. 932; *Basalt Rock Co.* v. *Commissioner,* 180 F. 2d 281 (9th Cir. 1950), *cert. denied,* 339 U. S. 966; *Beal* v. *United States,* 182 F. 2d 565 (6th Cir. 1950), *cert. denied,* 340 U. S. 852; see Stern, *Denial of Certiorari Despite a Conflict,* 66 Harv. L. Rev. 465 (1953) (describing the above cases). Those cases all involved clear conflicts among circuits and several involved questions applicable to a large number of pending claims arising prior to the change of law; neither factor is present in this case.

III. THE DECISION ON THE TRANSFER BETWEEN CORPORATE POCKETS TRANSACTION IS LIMITED TO THE FACTS OF THIS CASE AND DOES NOT HAVE BROAD SIGNIFICANCE.

The decision that the transfer of shares between Lamb Industries (97% owned by Lamb interests) and Lamb Enterprises (100% owned by Lamb interests) did not con-

stitute a "purchase" under Section 16(b) is limited to the particular fact situation. The Court of Appeals explicitly declined to formulate a general rule (R. A98). Therefore, there is no "special and important reason" for this Court to review that decision.

IV. THE DECISION BELOW AS TO BOTH TRANSACTIONS WAS CORRECT.

The decision was correct. In accordance with clear Congressional intent, and contrary to Petitioner's contention (Petition, page 13), the decision below does not require proof in each case that the insider obtained or misused confidential information in order to establish liability under Section 16(b). The Court of Appeals held that in determining whether a conversion is a "sale" within the meaning of Section 16(b) "the question is whether the conversion facilitates short-term speculative trading in the issuer's preferred." (R. A93) It concluded that, because the conversion did not alter the insider's investment position, the purchase and conversion within six months could not be used by an insider to facilitate short-term speculation. The Court of Appeals held therefore that the conversion was not a "sale" within the meaning of Section 16(b). In a similar situation, the Third Circuit in *Heli-Coil Corp. v. Webster, supra,* also held that there was no liability, but on the basis that there was no "profit realized". The Securities and Exchange Commission in its *amicus* brief supported the latter rationale. Under either rationale, the result in so far as Respondents are concerned is the same—there is no liability under Section 16(b).[4]

The Court of Appeals' holding that the transfer of an equity security from a company 97% controlled by Respondents to another company 100% controlled by Respondents

[4]Petitioner incorrectly states (Petition, page 12 and footnote 6) that the Congressional history shows an intention to include conversions as "sales". None of the authorities cited in footnote 6 of the Petition supports that statement.

was not a "purchase" is in accord with the only other decision in point, *Blau* v. *Mission Corp.*, 212 F. 2d 77 (2d Cir. 1954), *cert. denied*, 347 U. S. 1016, and with the position taken by the Securities and Exchange Commission in its *amicus* brief.

CONCLUSION

The Petition seeks review of a decision that (i) is not in conflict with a decision of the Court of Appeals of any other circuit, (ii) in so far as it relates to the Conversion Transaction is of very limited significance because of the adoption by the Securities and Exchange Commission of Rule 16b-9, and (iii) in so far as it relates to the Transfer Between Corporate Pockets Transaction is of limited significance because it is applicable only to the facts of this case. Furthermore, the decision below on both transactions is clearly correct. Accordingly, the petition for a writ of certiorari should be denied.

Respectfully submitted,

ALBERT R. CONNELLY
ROBERT ROSENMAN
Counsel for Respondents
One Chase Manhattan Plaza
New York, New York 10005

CRAVATH, SWAINE & MOORE
Of Counsel.

November 7, 1966.

APPENDIX

Rule 16b-9 Under the Securities Exchange Act of 1934
(Effective February 17, 1966)

Exemption from section 16(b) of transactions involving the conversion of equity securities.

(a) Any acquisition or disposition of an equity security involved in the conversion of an equity security which, by its terms or pursuant to the terms of the corporate charter or other governing instruments, is convertible immediately or after a stated period of time into another equity security of the same issuer, shall be exempt from the operation of section 16(b) of the Act: *Provided, however,* That this section shall not apply to the extent that there shall have been either (1) a purchase of any equity security of the class convertible (including any acquisition of or change in a conversion privilege) and a sale of any equity security of the class issuable upon conversion, or (2) a sale of any equity security of the class convertible and any purchase of any equity security issuable upon conversion (otherwise than in a transaction involved in such conversion or in a transaction exempted by any other rule under section 16(b)) within a period of less than 6 months which includes the date of conversion.

(b) For the purpose of this section, an equity security shall not be deemed to be acquired or disposed of upon conversion of an equity security if the terms of the equity security converted require the payment or entail the receipt, in connection with such conversion, of cash or other property (other than equity securities involved in the conversion) equal in value at the time of conversion to more than 15 percent of the value of the equity security issued upon conversion.

(c) For the purpose of this section, an equity security shall be deemed convertible if it is convertible at the option of the holder or of some other person or by operation of the terms of the security or the governing instruments.